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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 875

LYNDON A. DURANT, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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February 28, 1964.

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The petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above-entitled case on November 6, 1963.

CITATION TO OPINIONS BELOW

The opinion of the Court of Appeals, affirming the conviction of petitioner, was rendered on November 6, 1963, and is reported at 324 F. 2d 859. It is reprinted in Appendix A hereto, p. 1a, *infra*. The findings of

fact and opinion of the District Court for the Northern District of Illinois, Eastern Division, dated October 1, 1962, are reported at 208 F. Supp. 890 and are reprinted in Appendix B hereto, p. 13a, *infra*.

JURISDICTION

The judgment of the Court of Appeals was entered on November 6, 1963. A timely petition for rehearing was denied on December 30, 1963. On January 20, 1964, Mr. Justice Clark signed an order extending the time for filing this petition to and including February 28, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether, in a prosecution of an individual corporate executive for willful attempt to evade or defeat a personal income tax in violation of 26 U.S.C. § 7201, the requirement of willfulness can be proved merely by a series of negligent omissions to cure defective corporate accounting procedures where there is a complete absence of proof of any affirmative act of fraud, concealment or other bad faith or evil intent by the defendant.

STATUTE INVOLVED

This case involves Section 7201 of the Internal Revenue Code of 1954, 26 U.S.C. § 7201:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition, to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

STATEMENT OF THE CASE

A three-count indictment charged that petitioner did willfully attempt to defeat and evade a large part of the income tax due and owing by him and his wife to the United States for the calendar years 1954, 1955 and 1956. The alleged tax deficiencies for these three years totalled $142,714.00. The taxes actually paid aggregated $193,949.50.

Petitioner pleaded not guilty. He was tried, without a jury, by Judge Hubert L. Will of the District Court for the Northern District of Illinois, Eastern Division. Motions for judgment of acquittal were denied at the close of the Government's case and at the close of all the evidence. Petitioner was found guilty as charged. He was then sentenced to imprisonment for a period of 60 days on each count, the sentences to run concurrently, and fined $15,000 and costs. The judgment of conviction was affirmed on appeal by the Court of Appeals for the Seventh Circuit.

The District Court, pursuant to Rule 23(c) of the Federal Rules of Criminal Procedure, entered Special Findings of Fact (Appendix B hereto, pp. 13a-18a, *infra*) and an Opinion (Appendix B hereto, pp. 18a-23a, *infra*). Those Special Findings may be summarized as follows:

(1) Petitioner at all times was the president, chief executive officer and sole stockholder of United Manufacturing Company (hereinafter called "United"). Additionally, he was United's chief engineer, designer and electronic specialist.

(2) The tax returns for two of the three years in question were prepared by one Oettinger, vice president of United, the third return being prepared by an independent certified public accountant. Petitioner had delegated to Oettinger supervision of the cor-

poration's administrative affairs; and Oettinger was responsible for the keeping of all corporate books of account during the tax years.[1] One Taibleson, a certified public accountant, was United's controller during these years and, as such, was subordinate to Oettinger.[2] A Miss Croson, who also was subordinate to Oettinger, was in charge of accounts payable.[3]

(3) During the three years in question—1954, 1955 and 1956—United made expenditures for or on behalf of petitioner and for his personal economic benefit aggregating $815,021.08, of which $602,692.11 was charged to a personal account on the corporation's books entitled "L. A. Durant."[4] The remainder, total-

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[1] Oettinger testified that petitioner had never given him instructions as to how to charge any particular item on United's books. App. 338. Nor did Oettinger ever discuss his preparation of petitioner's tax returns with petitioner, save for one matter not here relevant. App. 340-342. As to the "L.A. Durant" account, Oettinger never reviewed the account in detail with petitioner. App. 338. He stated that "at various times Mr. Durant would ask me what the balance of the account was, and I would either go look or ask somebody to get the balance and gave it to him." App. 138.

[2] Taibleson also testified that petitioner had never advised or instructed him or any one else how bills should be charged on the company books. App. 59, 75. And he never reviewed the corporation's income tax returns with petitioner. App. 82.

[3] Both Miss Croson and Miss Warden, who handled the accounts payable and distributed the bills to the accounts to be charged, indicated in their stipulated testimony that they never asked petitioner and he never told them how to charge or how to handle any items to the accounts payable and the daily pay-outs. Whenever they had any questions they would ask Oettinger. App. 46-52.

[4] The stipulated facts showed that from its inception in 1946 through 1956, the "L.A. Durant" account had charges of $1,556,296.44 and credits of $1,488,480.92. App. 19. During the years 1954, 1955 and 1956, charges were made to this account totalling $602,692.11 and petitioner made repayments to the account totalling $612,510.20. App. 18-19; Def. Ex. 1.

ling $212,328.97, was charged to various corporate accounts and was not reported as income by the petitioner and his wife in their joint returns for the years in question. This $212,328.97 was distributable among the three years as follows:

1954	$ 51,716.17
1955	66,877.19
1956	93,735.61
Total	$212,328.97.

(4) Each of the expenditures by United reflected by the $212,328.97 figure had been recorded in the records of United either as expenses of the corporation and deducted by it as business expenses in its corporate tax returns or as an acquisition of an asset by United and thereafter depreciated, the depreciation being then deducted on the corporate tax returns. None of these expenditures, however, constituted a corporate expense or an acquisition of assets, all of them being for the personal economic benefit of petitioner.

(5) In December 1951 the corporate tax returns of United for the years 1949 and 1950 were examined by a revenue agent, Zivin. He questioned several categories of items in the corporation's books and records of account, one of which was the use of corporate funds for personal expenses. In the course of auditing the returns, Zivin "had several conferences at which both the defendant [petitioner] and Oettinger were present and in which the question of charging personal expenses to the corporation was discussed." Finding No. 10, p. 16a, *infra*. At the final conference on December 23, 1951, Zivin discussed all the questioned categories with petitioner and Oettinger and advised them that the practice of charging personal expenses to the corpo-

ration should be stopped. The petitioner "*replied that if there were personal expenses charged to the corporation, they should be charged to his personal account.*" Finding No. 10, p. 16a, *infra*.

(6) In February 1954 a second revenue agent, Wagar, examined United's returns for the years 1949 through 1953. He questioned the same categories questioned earlier by Zivin and disallowed substantial personal expenses of petitioner which had been charged to the corporation during these years. Wagar also had conferences with petitioner and Oettinger, informing petitioner that it was improper to charge personal expenses to the corporation "*although Agent Wagar did not discuss the specific items with the defendant [petitioner] but discussed them with Oettinger.*" Finding No. 11, pp. 16a-17a, *infra*.

(7) Neither petitioner nor anyone else instructed the controller Taibleson to make any changes in the bookkeeping or accounting practices of United after either agent's examination. On occasion, petitioner brought invoices or bills to Taibleson and directed him to pay them without designating any account to which they were to be charged. Without some specific direction to charge an item to petitioner's personal account, the District Court found, "it was the established practice of the corporation to charge such items to various corporate accounts." Finding No. 12, p. 17a, *infra*.

(8) On a number of occasions during the years 1954 through 1956 the petitioner instructed United's purchasing agent, Olson, to purchase merchandise for him. The District Court found that on no occasion did petitioner "instruct Olson to charge the purchases to his personal account and, pursuant to the established prac-

tice of the corporation, Olson charged such purchases to various corporate accounts." Finding No. 13, p. 17a, *infra*.[5]

As a result of the foregoing Special Findings, the District Court concluded that (a) petitioner knew at the time he filed his 1954, 1955 and 1956 income tax returns that he had taxably income as a result of these various payments by United for his personal economic benefit; (b) each of the tax returns for the three years was false when filed and petitioner knew them to be false; and (c) petitioner willfully and knowingly attempted to evade and defeat part of the income tax due and owing by him and his wife for each of the three years by knowingly and intentionally filing false returns in which he intentionally and falsely stated their joint taxable income and the income tax due thereon. Findings No. 14, 15, 16, pp. 17a-18a, *infra*.

In its Opinion, the District Court disposed of the contention that the corporate payments on petitioner's behalf could be considered as loans by ruling that the evidence indicated no intent or action which would support such a contention. See pp. 19a-20a, *infra*. The second contention, that petitioner did not have the requisite criminal intent, was rejected on two grounds:

First, as to claim that petitioner did not know that United was paying his personal expenses since he had delegated responsibility for maintenance of the books to subordinates, the court said that there was no evi-

[5] The court further found that on some occasions petitioner would instruct Olson to make purchases for a separate corporate project known as "Caravan" and would indicate that such purchases were to be charged to the Caravan account. See p. 17a, *infra*.

dence that petitioner, after the visits and advice of the two revenue agents, ever instructed his subordinates to change the practice of charging any bill or invoice submitted by him to a corporate account unless he specifically designated otherwise. But the District Court conceded that there was "no evidence that the defendant at any time instructed his subordinates to adopt this practice and to charge his personal expenses to corporate accounts." See p. 21a, *infra*.

The District Court found it difficult to believe, in light of the 2,572 personal items charged to corporate accounts over the three years, that petitioner was unaware of the manner in which they were being handled on the corporation's books. The court added that the fact that petitioner on occasion had personally issued corporate checks for personal expenses, without indicating to or advising his subordinates that the checks were in fact for personal expenses, added to the court's disbelief of petitioner's claimed ignorance. See p. 21a, *infra*.

Secondly, as to claim that if petitioner knew of the corporation's practices in this respect he did not know that the items were income to him that should be reported, the court concluded that since such items were similar in nature to the more than $105,000 of disallowed corporate expenses previously charged to him as income by the revenue agents in the prior audits he must have known the items here involved were also income to him. See pp. 21a-22a, *infra*.

The District Court then enunciated the test of willfulness by which it judged this case and by which it concluded that petitioner had willfully attempted to

evade a part of his income tax obligations for the years 1954-1956 (See p. 22a, *infra*):

> "Defendant here, however, after being warned by two revenue agents that the charging of personal expenses to corporate accounts and the failure to report such items as income in his joint returns was improper, made no change whatsoever in the challenged practices. What may have been negligence or mere understatement of income in the earlier years can hardly be so considered in later years after the agents' warnings. The only reasonable inference from defendant's conduct is that he deliberately and wilfully continued practices which he had been advised were improper and the effect of which was substantially to understate his taxable personal income.
>
> "There is a point of repetition at which action originally careless or negligent becomes deliberate and wilful. The defendant passed that point when, after warnings by two revenue agents, he did nothing but continue the improper and challenged practices."

In affirming the District Court's judgment, the Court of Appeals approved that court's determination as to petitioner's willfulness in the following language (pp. 9a-10a, *infra*):

> "Defendant submits that the most that can be inferred from the evidence in this case is a certain amount of laxity, but his counsel urges that any amount of laxity does not constitute the requisite willfulness.
>
> "As an abstract proposition, we would agree that no amount of laxity in and of itself constitutes willfulness. However, in the case at bar, we believe that the district court properly recognized the additional factors revealed by the records, tending to prove a willful intent: (a) defendant

knew the corporation was paying his expenses, (b) the payments were not considered loans by the parties, (c) defendant knew the corporate payments were income to him; and therefore properly found that defendant willfully failed to include them in his returns.

"As we have indicated, the events following the prior audits for 1949-1953 served to clearly warn defendant of his duty to report as his personal income the charges of indebtedness incurred by him and paid by the corporation. Moreover, his failure to indicate on many of the expenditure vouchers any notation indicating appropriate classifications leading to a proper charge to him personally, also tends to support the finding of willfulness.

"His continuous failure to see that the warnings of Zivin and Wagar were heeded might reasonably be expected to result in a continuation of the practice of charging his personal obligations to the corporation."

REASONS FOR GRANTING THE WRIT

1. The decision below raises an important question in the criminal administration of the revenue laws as applied to normal modes of operation in the business world.

In this modern day when busy corporate executives frequently charge personal expenses in the first instance to their corporations, leaving to their administrative subordinates the task of properly allocating those expenses to their personal accounts on the corporate books, it becomes important to resolve the recurring question of their criminal responsibility for improper and negligent bookkeeping practices.

Is such a corporate executive to be held guilty of willfully attempting to evade his own income tax obligations because of the derelictions of those to whom he delegated the functions of keeping the corporate

records in proper order? Must he, despite any lack of accounting or bookkeeping expertise, affirmatively enter into the day-to-day ministerial function of seeing to it that a particular personal expense is charged to his personal rather than a corporate account on the ledger book? Does he subject himself to criminal sanctions by doing no more than repaying from time to time the amounts which his subordinates tell him he owes on his personal account, amounts later found to be incomplete or imperfect?

These questions arise in the context of a case where there is a total absence of any finding of willfulness or criminal intent other than what has been deduced from a feeling that petitioner was negligent over a period of time. Willfulness has been found not from what petitioner actually did but from what he should have done. What he actually did was no more than what most executives do—charge personal expenses to the corporate treasury and trust that his subordinates will make the proper bookkeeping allocations and charge him with the proper personal expenses.

This case finds an almost exact parallel in *United States* v. *Allen*, 44 Amer. Fed. Tax Rep. 894 (S.D. Cal., Nos. 20984-20984-4, 1950), where Judge Yankwich set aside a jury verdict of guilty as to corporate executive who, "busy with other affairs, trusted to the bookkeeping of those he employed for the purpose of making a full and accurate account of the moneys". There, as here, the subordinates were unanimous in their testimony that the executive never told them "to falsify any record or to make any entry which did not conform to reality." There, as here, the facts as to the allocations actually made on the books were never called to the attention of the executive. And there,

as here, there was a complete absence of the factors usually found in cases of true willful criminal intent—"failure to keep books, destruction of records, deliberate instructions to persons keeping records not to make full disclosures and the like."

What Judge Yankwich concluded illustrates both the importance and the impropriety of inflicting criminal liability on a busy executive in such a situation (*Id.*, p. 896):

> "... in view of the large scope of his operations and the hundreds of thousands of dollars that went in and out of this one account in which was placed all the moneys coming to him whether derived from income as reimbursement, as money advanced from loans and other, knowledge cannot be imputed to him to the extent of making him criminally liable. Grant that this amounts to carelessness of the most gross kind. It is not sufficient to supply the criminal design which is the essence of this offense."

Moreover, the problem of the extent to which general corporate negligence can be translated into the specific willful intent necessary to convict the top executive of a violation of 26 U.S.C. § 7201 is important not only to the business community but to the proper administration of the revenue laws. As one commentator has said with respect to the administration of the civil penalties of the Revenue Code,[6]

> "Where the record discloses *gross negligence* or *reckless disregard* of the taxpayer's responsibility to file or to have someone else prepare and file a true tax return, the temptation to infer

[6] Balter, *The Line Between Negligence and Fraud*, New York Univ. Twelfth Annual Institute on Federal Taxation, p. 25 (1954).

> fraudulent intent from these facts is, of course, very understandable. It is in this area that we find the most acute disagreements between the Commissioner, the Tax Court and the various Courts of Appeals."

The same type of disagreement is even more acute and significant with respect to the criminal sanctions of the Code.

If the decision below stands without some definitive clarification of the problem by this Court, general corporate laxness means criminal liability for the executive officer. Corporate executives must then act in dire peril in following what has become a normal and accepted mode of operation in the business world. The implications of such a result merit the full consideration and attention of this Court.

2. The decision below conflicts with the relevant decisions of this Court and of other Courts of Appeals as to the standard to be applied in determining whether and to what extent negligence can be equated with willfulness under § 7201.

The decision of the court below to the effect that willfulness for purposes of 26 U.S.C. § 7201 can arise from long continued negligent practices with respect to corporate records is at war with the concept of criminal willfulness as developed by this Court and other Courts of Appeals.

Indeed, the opinion below is irreconcilable with the principles established by this Court in *Spies v. United States*, 317 U.S. 492, 498-499. The Court there indicated that by enacting what is now § 7201—"the gravest of offenses against the revenues"—Congress intended that there be proof of "some willful commission in addition to the willful omissions" punishable as

misdemeanors under what is now § 7203. There must thus be proof of "a willful and positive" or "affirmative" attempt to evade taxes rather than just a "passive neglect." But the court below ignored these principles in ruling that the repetition of negligence or "passive neglect" can reach a point where it becomes proof of deliberateness or willfulness, without some "positive" or "affirmative" act intervening.

The court below agreed, as "an abstract proposition," that no amount of laxity in and of itself constitutes willfulness for purposes of § 7201. It then proceeded to hold that more than laxity was involved here since (a) petitioner knew the corporation was paying his expenses, (b) the payments were not considered loans, (c) petitioner knew the corporate payments were income to him, (d) petitioner failed to heed prior warnings from revenue agents, and (e) petitioner failed to indicate proper classifications on many of his expenditure vouchers.

Those five factors, however, are either irrelevant to the question at hand or constitute no more than an extension of the laxity or negligence which the court conceded was inadequate to constitute willfulness. Factors (a), (b) and (c) merely reflect a practice, not challenged by the law, of charging personal expenses in the first instance to the corporation; the problem then becomes one of allocating the personal expenses to the personal account in the corporate books. Factor (e) is clearly of the negligent variety, indicating that petitioner should have been more careful with respect to voucher identifications.

It is factor (d) which was critical to the District Court's finding of wilfulness—a finding that petitioner

did not heed the agents' warning that charging personal expenses to corporate accounts was improper and that such items should have been reported as personal income. But the District Court itself found that when the first agent gave this warning petitioner "replied that if there were personal expenses charged to the corporation, they should be charged to his personal account." Finding No. 10, p. 16a, *infra*. And as to the second agent's warning, the court found that the agent "did not discuss the specific items with the defendant but discussed them with Oettinger." Finding No. 11, p. 17a, *infra*. The Court further found "no evidence that the defendant at any time instructed his subordinates to. . . charge his personal expenses to corporate accounts." See p. 21a, *infra*.

The improper bookkeeping practices then continued —without a shred of evidence that petitioner knew, let alone directed, that the warnings went unheeded by those subordinates responsible for the corporate accounting. He assumed, perhaps negligently, that Oettinger (who was present when the agents gave their warnings) would see to it that all of these items would be charged to his personal account. That assumption was reasonable to the extent that $602,692.11 was properly charged to his personal account during the three years in question, and $1,556,296.44 so charged over a ten-year period. App. 18-19; Def. Ex. 1.

Yet the District Court found, and the Court of Appeals agreed, that there "is a point of repetition at which action originally careless or negligent becomes deliberate and wilful" and that what "may have been negligence or mere understatement of income in the earlier years can hardly be so considered in later years after the agents' warnings." See p. 22a, *infra*. In

other words, negligence plus more negligence becomes willfulness for purposes of § 7201. Such a conclusion is contradicted by both the intent of § 7201 and the relevant appellate court decisions as to the concept of willfulness.

This Court in *United States* v. *Ragen*, 314 U.S. 513, 515, held that in a prosecution for willful attempt to evade or defeat a tax it must be shown that the acts complained of "were willfully done in bad faith and with intent to defeat the tax." And in *Spies v. United States*, 317 U.S. 492, 499, the Court indicated in a general way various forms of deceitful practices that would permit an inference of such bad faith—"keeping a double set of books, making false entries on documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or confuse."[7]

Thus the requisite evil intent must involve some conscious effort to conceal or falsify. There must be something more than negligence, carelessness, misunderstanding or unintentional understatement of income. As this Court said in *United States* v. *Murdock*, 290 U.S. 389, 396:

> "Congress did not intend that a person, by reason of a bona fide misunderstanding as to his liability for a tax . . . *or as to the adequacy of the rec-*

[7] See also *Holland* v. *United States*, 348 U.S. 121, 139, where an inference by the jury of willfulness was permissible where there was evidence of a failure on petitioners' part "to include all of their income in their books and records," as well as a consistent pattern of underreporting of large amounts of income. In the instant case, all the personal expenditures were fully identifiable from the corporate records and the District Court made no findings as to any concealment of the expenditures.

> *ords he maintained,* should become a criminal by his mere failure to measure up to the prescribed standard of conduct." [Emphasis supplied.]

Reliance on the basic principles thus enunciated by this Court has led a number of Courts of Appeals to rule that mere negligence—even gross and repeated negligence—is not enough to establish willfulness under § 7201. See *Pappas* v. *United States,* 216 F. 2d 515, 519 (C.A. 10); *Gaunt* v. *United States,* 184 F. 2d 284, 291, n. 4 (C.A. 1); *United States* v. *Pechenik,* 236 F. 2d 844, 846 (C.A. 3). In the words of the Third Circuit, *United States* v. *Martell,* 199 F. 2d 670, 672, a willful evasion of a tax "requires an intentional act or omission as compared to an accidental or inadvertent one. It also requires a specific wrongful intent to conceal an obligation known to exist, as compared to a genuine misunderstanding of what the law requires or a bona fide belief that certain receipts are not taxable." In short, the Government must show some "affirmative action." *United States* v. *Mollet,* 290 F. 2d 273, 274 (C.A. 2).

The failure to find such "affirmative action" in this case and the resulting conflict with the foregoing cases are highlighted by the Third Circuit's decision in *United States* v. *Pechenik,* 236 F. 2d 844, 846, which, on substantially similar facts, reached the opposite result from that rendered below. In *Pechenik,* a corporate executive's conviction for having willfully understated the income and tax obligations of the corporation was reversed. There, as in this case, the executive had turned over the books, bookkeeping and preparation of tax returns to the bookkeeper and accountant. There, as here, there was no evidence that the executive ever interfered with the books or that he was in any way linked with the erroneous bookkeeping. All that

was left, as here, was the suggestion that the executive had been negligent, plus the expressed disbelief that the executive did not really know what had transpired on the corporate books. Negligence and incredulity, however, were ruled inadequate as "probative evidence linking the defendant with the erroneous books and tax returns in any manner which should result in his conviction of the offense charged." 236 F. 2d at 846. That conclusion in *Pechenik* cannot be squared with the one reached below.[8]

While the standard of willfulness admits of no inclusive or comprehensive definition, applicable to all cases, it does lend itself to a delineation which rejects negligent omissions to check on corporate bookkeeping operations. And to hold as the court did below, that a series of omissions, concededly negligent in nature at the start, can somehow reach the point where negligence ceases and willfulness begins—without any affirmative act of concealment, fraud or evil intent intervening—is to reach a result in conflict with the principles laid down by this Court in the *Ragen, Spies* and *Murdock* cases, as well as with the Third Circuit's ruling in *Pechenik*.

The importance of the question thus presented, combined with the clear conflicting decisions, justifies an invocation of this Court's review powers.

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[8] See 10 Mertens, Law of Federal Income Taxation (Zimet revision, 1958) § 55A.09: "A distinction must be drawn between carelessness of the 'most gross kind' and the 'criminal kind' which is the essence of the offense. . . . Before a conviction under the Code can be sustained the record must reveal probative evidence linking the defendant with the erroneous books and tax returns. Reliance upon the conduct of employees in good faith is not a punishable event. A mistake, standing alone, is not sufficient to sustain a conviction."

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari to review the judgment of the Court of Appeals for the Seventh Circuit should be granted.

Respectfully submitted,

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